# INDEX


| | Page |
|---|---|
| Opinions below | 1 |
| Jurisdiction | 1 |
| Question presented | 2 |
| Statute and regulations involved | 2 |
| Statement | 2 |
| Summary of argument | 6 |
| Argument: | |
| Glidden was not a party to the statutory reorganization effected between the old company, Indiana, and the new company, Ohio | 7 |
| Conclusion | 13 |
| Appendix | 14 |


## CITATIONS


| | |
|---|---|
| Cases: | |
| *Bus & Trans. Corp.* v. *Helvering*, 296 U. S. 391 | 10, 12 |
| *Fifth Avenue Bank of New York* v. *Commissioner*, 31 B. T. A. 945, affirmed, 84 F. (2d) 787 | 5 |
| *Helvering* v. *Raymond I. Bashford*, No. 33, present Term | 5, 6, 8, 11, 13 |
| *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378 | 10 |
| *Pinellas Ice Co.* v. *Commissioner*, 287 U. S. 462 | 10 |
| Statute: | |
| Revenue Act of 1928, c. 852, 45 Stat. 791, Sec. 112 | 14 |
| Miscellaneous: | |
| Treasury Regulations 74, Art. 577 | 16 |




21171—37——1

# In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 21

HERMAN C. GROMAN, PETITIONER

*v.*

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

*ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT*

## BRIEF FOR THE RESPONDENT

### OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals (R. 10–18) is unreported. The opinion of the Circuit Court of Appeals (R. 43–47) is reported in 86 F. (2d) 670.

### JURISDICTION

The judgment of the Circuit Court of Appeals was entered November 30, 1936 (R. 47), and a petition for rehearing was denied January 7, 1937 (R. 48). The petition for writ of certiorari was filed April 5, 1937, and was granted May 24, 1937 (R.

49). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

## QUESTION PRESENTED

Taxpayer owned stock in A corporation, which transferred its assets to B corporation in a statutory reorganization. Taxpayer exchanged his stock in A corporation for stock in B corporation, cash, and stock in C corporation. C corporation is the parent of B and the instigator of the reorganization plan. The question is whether the gain represented by the C stock is taxable. This depends upon whether the C stock is stock of a corporation a party to the reorganization, under Section 112 (b) (3), or "other property" under Section 112 (c) (1), Revenue Act of 1928.

## STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*, pp. 14–18.

## STATEMENT

The facts in this case were found by the Board of Tax Appeals pursuant to a stipulation of the parties (R. 11–14), and may be summarized as follows:

Prior to January 29, 1929, the petitioner and others were stockholders in Metals Refining Company, located in and incorporated under the laws of Indiana. Metals Refining Company, herein

called Indiana, had an authorized capital stock of $500,000 consisting of 5,000 shares of a par value of $100 each, of which 4,421 shares were issued and outstanding on January 29, 1929. Indiana was engaged in the business of refining lead and in the production of various alloys. The Glidden Company, herein called Glidden, is and was on January 29, 1929, a corporation organized and existing under the laws of Ohio, engaged principally in the manufacture of paints and varnishes (R. 11).

Under date of January 29, 1929 an agreement was executed between Glidden and the holders of all of the outstanding stock of Indiana, the premises of which set out (R. 11) that the stockholders of Indiana desired to merge or consolidate Indiana's property with Glidden and with a new corporation to be organized under Ohio laws as provided in the agreement. The stockholders agreed to sell their Indiana shares to a corporation to be organized under Ohio laws by Glidden, the new corporation to have 5,000 preferred shares of a par value of $100 each and to have such number of common shares as Glidden should determine. All the common shares were to be acquired by Glidden for a cash consideration. Glidden agreed to organize a new corporation, which would have the authority to carry on Indiana's business and agreed that on the transfer of the Indiana stock to it by the holders thereof it would cause its (Glidden's) assets to be conveyed to the new company.

Glidden further agreed that as a consideration for the consolidation it would issue and deliver shares of its own stock and of the new company to Indiana's stockholders and would make those stockholders a cash payment in an agreed amount (R. 12–13).

Pursuant to this contract Glidden caused to be organized under the laws of Ohio a corporation named Metals Refining Company of Ohio, herein called Ohio, which had preferred and common stock. Then followed the transfer to Ohio by the petitioner and the other stockholders of Indiana of their stock in Indiana, soon after which Glidden, which was, under the agreement, the owner of the common stock of Ohio but which did not receive any of its preferred stock, caused the properties and assets of Indiana to be conveyed and transferred to the new company, Ohio. Indiana was thereafter dissolved (R. 13).

Further carrying out the agreement, each stockholder of Indiana, including the petitioner, received a proportionate amount of the cash payment as computed in the agreement, of Ohio stock, and of Glidden stock (R. 14). The Commissioner of Internal Revenue determined that Glidden was not a party to the reorganization which he conceded to have been effected between Indiana and the new company, Ohio. Consequently, he treated as taxable income not only the cash received by the petitioner in the exchange but also the fair market

value of the preferred stock of Glidden which the petitioner had received (R. 14).

The Board of Tax Appeals reversed the determination of the Commissioner upon the authority of its own earlier decision in *Fifth Avenue Bank of New York* v. *Commissioner,* 31 B. T. A. 945, affirmed by the Circuit Court of Appeals for the Third Circuit, 84 F. (2d) 787, in which it was held that a parent corporation similarly situated to Glidden "was so intimately connected with the several transactions which resulted in the statutory reorganization that in our opinion it must be held to be a party to the reorganization within the statutory sense of the term" (R. 17). Accordingly, the Board held that the stock of Glidden as well as that of Ohio was received by the petitioner without recognition of gain.

The Circuit Court of Appeals for the Seventh Circuit reversed the decision of the Board and held the Board's construction of the statute to be an unwarranted extension of the term "a party to a reorganization" under Section 112 (i) (2), of the Revenue Act of 1928 *infra,* p. 16.

The petitioner filed a writ of certiorari in this Court, No. 854, October Term, 1936, and the respondent did not oppose because of a contrary construction of the same statutory provision which had been adopted by the Circuit Court of Appeals for the Third Circuit in *Commissioner* v. *Bashford* 87 F. (2d) 827, which involved an al-

most identical transaction, and which is now pending before this Court, No. 33, October Term, 1937. This Court granted the writ.

## SUMMARY OF ARGUMENT

There was a reorganization between Indiana and the new company, Ohio. But Glidden was not reorganized and was not a party to the reorganization either within the literal terms of the statutory definition or within its purpose.

The definition of "a party to a reorganization" is found in Section 112 (i) (2). This provision follows the definition of "reorganization" found in Section 112 (i) (1) and plainly must be read in connection with the definition of reorganization. The fundamental principle laid down by this Court in the construction and application of reorganization provisions is that for a party to an exchange to come within the exemption provisions he or it must acquire an immediate, definite and material interest in the assets and affairs of the other party. Plainly, stock in another corporation does not provide a definite and direct interest in the transferred assets, even though the second corporation may own stock in the transferee.

We have argued fully in the brief for the petitioner in *Helvering* v. *Bashford,* No. 33, October Term, 1937, that (1) Atlas in that case was not a party to the reorganization within the literal terms of the statutory definition and (2) Atlas was not a

party to the statutory reorganization because it conceived and executed a general plan which included such a reorganization. As the facts of the two cases are very similar and as Glidden in this case stands in the same position as Atlas in that case, those arguments are equally applicable to the facts of this case and accordingly the arguments of the *Bashford* case are incorporated herein by reference and are made a part hereof.

## ARGUMENT

### GLIDDEN WAS NOT A PARTY TO THE STATUTORY REORGANIZATION EFFECTED BETWEEN THE OLD COMPANY, INDIANA, AND THE NEW COMPANY, OHIO

The taxpayer in this case, one of the stockholders in Indiana, the dissolved company, exchanged his stock therein for stock of the new company, Ohio, for stock of Glidden, and for cash. There is no controversy as to the reorganization accomplished under the plan whereby Ohio acquired, first, all the stock of Indiana, and, second, all its properties and assets. This acquisition of stock and properties has been treated by both parties at all times as having effected a statutory reorganization within the meaning of Section 112 (i) (1) (A), Revenue Act of 1928, *infra*. Since it appears there was a reorganization between Indiana and Ohio, any gain represented by the stock of the new company is not recognizable under Section 112 (b) (3), Revenue Act of 1928, *infra*, because the new company

plainly was a "party" to the exchange constituting such reorganization.

The question here in issue is whether the gain to the taxpayer represented by the Glidden stock is to be unrecognized, as the petitioner contends, because that company must be regarded as a "party" to the reorganization within the meaning of the statutory definitions, or whether it is to be treated as taxable gain upon "other property" under Section 112 (c) (1), *infra*, as the respondent contends.

The question for determination in the instant case is identical with that presented in *Helvering* v. *Bashford*, No. 916, October Term, 1936, now No. 33 of the present term. In the *Bashford* case the Atlas Powder Company created a new corporation, which it controlled, for the specific purpose of acquiring the stock and the assets of three other corporations. The plan was carried out as proposed and in the exchanges between the three old corporations and the new subsidiary of Atlas a stockholder in one of the old corporations received cash, stock of the new company and stock of Atlas for his stock in the old company.

In both this and the *Bashford* case the Board of Tax Appeals held that the parent companies, Glidden and Atlas, were parties to the statutory reorganizations concededly effected between their newly created subsidiaries and other "old" corporations because of the parents' conception and execution of and intimate connection with the respective reorganization plans, and because there

would have been no reorganization in either case without the participation of the parent corporation.

In the instant case, the Circuit Court of Appeals for the Seventh Circuit, unlike that court for the Third Circuit, rejected the broad construction of the reorganization provisions adopted by the Board as an unwarranted extension of the definitions carefully included by Congress in the reorganization statute (R. 46). We believe the court below was correct in not feeling itself justified in extending the meaning of the term "party" as it appears in Section 112 (i) (2), *infra,* p. 16, to include Glidden under the facts of this case. The court pointed out that Congress has defined a party to a reorganization so as to permit a taxpayer to avoid what would otherwise be taxable income; that it could have refused to allow such deductions altogether; but that having exempted "gains" through reorganization, it could and did define reorganizations; and that in so doing it used the term "a party" to refer to "those who were in the reorganization" (R. 46). While relying upon the exemption from recognition of gain carefully expressed in the statute, the taxpayer declines to abide by the Congressional definition of the exemption terms.

The Congressional definition of a "party to a reorganization" here involved is found in Section 112 (i) of the Revenue Act of 1928, which defines a "reorganization". That section reads in part:

> (2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

The Government contends that the definition of a "party" plainly must be read in connection with the definition of a reorganization. In order to satisfy the statutory definition of "reorganization" a transfer of assets must be for a consideration which carries a definite, immediate and material interest in the assets transferred. *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378; *Bus & Trans. Corp.* v. *Helvering*, 296 U. S. 391; *Pinellas Ice Co.* v. *Commissioner*, 287 U. S. 462. In a statutory reorganization Congress has temporarily postponed the tax upon the receipt of stock or securities in a party to a reorganization. Section 112 (b) (4), *infra*, p. 14. If the term "party to a reorganization" be limited to corporations which have a definite, substantial and immediate interest in the transferred assets, then the taxpayer who receives the stock of such a corporation in an exchange will have a consideration which satisfies the requirements of the above cited cases and will qualify for the temporary postponement of the tax (which is often called a statutory exemption) under Section 112 (b) (4). Thus the Congressional intent or statutory pattern is carried out.

But if the stock of a corporation which does not have a substantial, immediate and definite interest in the transferred assets be received without recognition of gain, there will result a departure from the statutory pattern and the receipt of stock which, would not of itself answer the requirements of the above cited cases will nevertheless result in the same temporary postponement of tax as would the receipt of stock in the corporation which is, for example, in actual possession of the transferred assets. In so far as the enumeration of parties to a reorganization in Section 112 (i) (2) includes corporations which do not have a definite, immediate and substantial interest in the transferred assets, there is an exception to the general rule, for they must be recognized as parties. But we submit that this is no warrant for recognizing additional exceptions, as the Board has done in this and the *Bashford* case.

The case narrows itself to this: Do the same tests for determining whether or not a reorganization has occurred apply to the determination of the question whether a corporation is a party to the reorganization? We submit that the identical tests are applicable, and that a corporation which is not specifically enumerated in Section 112 (i) (2) may not be regarded as a party to the reorganization unless it has a definite, immediate and substantial connection with the transferred assets. When the assets of A Corporation are transferred to B Corporation, it would seem to be clear that B

is the only corporation which has a definite, immediate and substantial connection with the transferred assets of A. When A's stockholders exchange their stock for stock of B they retain the same relationship to the assets behind their investment that they had in the beginning. But if A's stockholders exchange their stock for the stock of another corporation, which we may call C, they have *pro tanto* surrendered their interest in the assets of A. To the extent that they have surrendered their interest, they have departed from the statutory concept of the tax-free exchange and can no longer have the benefit of the statute. Substantially, that was the situation in the *Bus & Trans. Corp.* case, *supra*. Here, the stockholders of A, or Indiana, received stock of two companies; in addition to the stock of Glidden, which corresponds to C in the above illustration, they received stock of Ohio, which corresponds to B in the above illustration. Under the *Bus & Trans. Corp.* decision an exchange of Indiana stock for Glidden stock alone would not have resulted in the exemption. We submit that the result should be no different because Ohio stock was received in addition to the Glidden stock. In other words, we concede that the Ohio stock is entitled to the exemption because it preserves the requisite interest in the assets of Indiana. No attempt is made in this case to tax any profit represented by the receipt of the Ohio stock. But in so far as the Glidden stock is con-

cerned, we submit that its taxability is not affected by the fact that Ohio stock was received in addition.

We have argued fully in the brief for the petitioner in *Helvering* v. *Bashford,* No. 33, October Term, 1937, that (1) Atlas in that case was not a party to the reorganization within the literal terms of the statutory definition, and (2) Atlas was not a party to the statutory reorganization because it conceived and executed a general plan which included such a reorganization. As the facts of that case are strikingly similar to the facts of this case, and as Atlas there stands in a similar position to Glidden here, those arguments are equally applicable to the facts of this case, and accordingly both points I and II of the argument in the *Bashford* case are incorporated herein by reference and made a part hereof.

## CONCLUSION

In view of the foregoing, we submit that the decision of the Circuit Court of Appeals should be affirmed.

Respctfully submitted.

STANLEY REED,
*Solicitor General.*
JAMES W. MORRIS,
*Assistant Attorney General.*
SEWALL KEY,
J. LOUIS MONARCH,
MAURICE J. MAHONEY,
*Special Assistants to the Attorney General.*

OCTOBER 1937.

## APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * *

(3) *Stock for Stock on Reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) *Same—Gain of Corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(c) *Gain from exchanges not solely in kind.*—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the

recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

(d) *Same—gain of corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

* * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) the term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(j) *Definition of control.*—As used in this section, the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 577. *Definitions.*—The term "reorganization" as used in sections 112, 113, and 115 means—

(1) A merger or consolidation (including the acquisition by one corporation of at

least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation),

(2) A transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred,

(3) A recapitalization, or

(4) A mere change in identity, form, or place of organization, however effected.

The term "a party to a reorganization" as used in sections 112 and 113 includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation. This definition is not an all-inclusive one, but simply enumerates certain cases with respect to which doubt might arise.

A person is, or two or more persons are, "in control" of a corporation, within the meaning of section 112, when owning—

(1) At least 80 per cent of the voting stock, and

(2) At least 80 per cent of the total number of shares of all other classes of stock of the corporation.

As used in section 112, as well as in other provisions of the Act, the conjunction "or" is used to denote both the conjunctive and the disjunctive, and the singular is used to include the plural. For example, the provisions of article 574 are complied with if

"stock and securities" are received in exchange as well as if "stock or securities" are received, and if securities in the same corporation, together with securities in another corporation a party to the reorganization or in other corporations parties to the reorganization, are received in exchange.

U. S. GOVERNMENT PRINTING OFFICE: 1937